

Consultation on the introduction of entry charges into the Northern Ireland postalised regime for gas

16 October 2014



About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

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Value and sustainability in energy and water.

Our Vision

We will make a difference for consumers by listening, innovating and leading.

Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference

Act with integrity.

Abstract

This paper sets out our proposals for the introduction of entry changes into the postalised regime as a consequence of changes that are required by European legislation and which we plan to implement in October 2015.

Audience

This document is likely to be of interest to regulated companies in the energy industry, government and other statutory bodies and consumer groups with an interest in the energy industry.

Consumer impact

The changes are necessary to ensure compliance with the European Gas Regulation and in particular the network codes required by the Regulation.

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1. Introduction

Purpose of this paper

- 1.1. The European Union (EU) adopted the third legislative package in July 2009 to further the development of a Single European Gas Market. A key element of the third legislative package for gas is Regulation (EC) 715/2009 (the Gas Regulation) which mandates the development of European network codes (EUNCs) covering areas such as tariffing, capacity allocation and interoperability in each member state.
- 1.2. The implementation of the Gas Regulation and the EUNCs will trigger changes to the Northern Ireland postalised regime. In particular the network code on capacity allocation mechanisms (the CAM code) requires Northern Ireland to introduce new capacity products. Entry charges will need to be deepened for these new products. CAM must be implemented by November 2015 but in effect this means that the necessary changes must be implemented by 1 October 2015 to coincide with the start of the new gas year.
- 1.3. This paper summarizes the changes that are required by European legislation which we plan to implement on 1 October 2015 and sets out our proposals for the introduction of entry charges into the postalised regime.
- 1.4. The European requirements summarized in the paper are:
 - That tariffs are set separately for every entry point into or exit point out of the transmission system;
 - The introduction of non-annual capacity products required by the CAM code. The new products will require new tariffs to be calculated and new rules to be developed to deal with the revenue from the sale of these products;
 - The use of auctions as the mechanism to allocate capacity as required by

the CAM code. New rules will need to be developed to deal with the calculation of reserve prices for auctions.

1.5. The Gas Regulation also requires that a network code on tariffs is implemented. This has not yet been agreed but has progressed to the stage where an initial draft code was approved by the ENTSOG Board in May 2014.¹ The proposals in this paper therefore do not cover implementation of each aspect of the draft network code on tariffs since at this stage the code has not been finalised; we will consult on the full implementation of the tariff code in late 2015/early 2016 once the code has been agreed.

1.6. However, in formulating proposals for the introduction of entry charges, we have taken account of the methodologies in the draft network code on tariffs which define rules for cost allocation between entry and exit points as it makes sense to implement the introduction of entry charges using a methodology likely to be permitted from 2017. We have also taken account of the draft rules in the tariff code on the setting of reserve prices (in particular those related to multipliers and seasonal factors for non-annual capacity products) and reconciliation. The intention of this approach is to ensure that the new postalised charging regime from October 2015 is in line with the draft tariff code where it is sensible to do so.

1.7. In relation to responsibility for capacity booking; the GDNs (Gas Distribution Network Operator) will continue to book exit capacity but once CAM is implemented at entry it is appropriate for suppliers to book entry capacity and therefore to participate in the auctions for entry capacity.

¹http://www.entsog.eu/public/uploads/files/publications/Tariffs/2014/TAR20014_Initial%20Draft%20TAR%20NC_for%20consultation.pdf

Overview of proposals

1.8. We consider that the changes required by European requirements can be accommodated within the Northern Ireland postalised regime by means of applying the postage stamp cost allocation methodology. Our substantive proposals in this respect are set out in section 5 below and include:

- The application of a postage stamp cost allocation methodology
- Apply the current capacity-commodity split and entry and exit points
- The entry-exit split as an output from the reconciliation process
- Make full use of the flexibility to set multipliers and seasonal factors.

Therefore the price of capacity is highly likely to be higher in winter than in summer.

- Reconcile entry and exit points together

1.9. We are proposing only two changes to the regime at exit and these are set out in section 6.

- To remove the daily capacity product at exit.
- To change the charging regime at exit to ensure that a supplier nominating above the level of booked capacity at an exit point will be charged an appropriate rate for capacity in addition to the commodity charge. This will ensure that all suppliers contribute appropriately to network costs.

1.10. The paper does not consult on any licence changes that are required to underpin any changes to the postalisation regime; these will be developed and consulted on separately by the Utility Regulator as set out in section 8.

Structure of this paper

1.11. The paper has the following sections:

- Section 2: Summary of current postalised regime

- Section 3: Summary of EU requirements to be implemented in 2015
- Section 4: Considerations in the design of the new tariff regime
- Section 5: Entry charging in the NI postalised regime – includes discussion of matters such as cost allocation methodology, capacity/commodity split and reconciliation
- Section 6: Consequential changes proposed to the NI postalised regime at exit
- Section 7: Overview of proposed postalised tariff process
- Section 8: Next steps/timetable and process for further work required
- Appendix 1: List of consultation questions

Responding to this consultation

1.12. We will hold an industry workshop on 16 October in order to present the issues in this paper. Invitations to this workshop have been issued to industry stakeholders separately.

1.13. The deadline for responses to the issues raised in this paper by 12 noon on 27th November 2014. Responses should be sent to:

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14 Queens Street

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1.14. The Utility Regulator's preference would be for responses to be submitted

by e-mail.

- 1.15. Individual respondents may ask for their responses (in whole or in part) not to be published, or that their identity should be withheld from public disclosure. Where either of these is the case, the Utility Regulator will also ask respondents to supply the redacted version of the response that can be published.
- 1.16. As a public body and non-ministerial government department, the Utility Regulator is required to comply with the Freedom of Information Act (**FOIA**). The effect of FOIA may be that certain recorded information contained in consultation responses is required to be put into the public domain. Hence it is now possible that all responses made to consultations will be discoverable under FOIA, even if respondents ask us to treat responses as confidential. It is therefore important that respondents take account of this and in particular, if asking the Utility Regulator to treat responses as confidential, respondents should specify why they consider the information in question should be treated as such.
- 1.17. This paper is available in alternative formats such as audio, Braille etc. If an alternative format is required, please contact the office of the Utility Regulator, which will be happy to assist.

2. Summary of current postalised regime

Overview of current postalisation arrangements in Northern Ireland

Legislative background to postalisation

2.1. The principle of postalisation was approved by the NI Executive and Assembly in September 2001 and was implemented in NI on 1 October 2004. Postalisation means that the charge for transporting gas along designated pipelines will be the same irrespective of where the gas is offtaken for final use.

2.2. Pipelines subject to the common (i.e. the postalised) tariff are designated by DETI under article 59 of the Energy Order. The high pressure pipelines designated by DETI for this purpose are as follows:

- SNIP (Scotland to NI Pipeline);
- BGTP (Belfast Gas Transmission Pipeline);
- NWP (North West Pipeline); and
- SNP (South North Pipeline).

2.3. In due course (subject to DETI designation) the high pressure network which will bring gas to the west of NI will also form part of the postalised network.

2.4. The UR's obligations in relation to the common tariff are established under

Article 14(1) and Article 14(2)(c) of the Energy Order and these provide as follows:

- “14(1) *The principal objective of the Department and the Authority in carrying out their respective gas functions is to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland, and to do so in a way that is consistent with the fulfilment by the Authority, pursuant to Article 40 of the Gas Directive, of the objectives set out in paragraphs (a) to (h) of that Article².*
- (2) *The Department and the Authority shall carry out those functions in the manner which it considers is best calculated to further the principal objective, having regard to—*
- ...
- (c) *the need to secure that the prices charged in connection with the conveyance of gas through designated pipe-lines (within the meaning of Article 59) are in accordance with a common tariff which does not distinguish (whether directly or indirectly) between different parts of Northern Ireland or the extent of use of any pipe-line;”.*

2.5. Postalisation in Northern Ireland has therefore been in place for ten years and as such it is well understood by all market participants. We have considered whether there is anything in the new EU requirements (including the draft tariff code) which is contrary to the principle of postalisation but we do not believe this to be the case.

2.6. As set out in section 5 we consider that the postage stamp cost allocation methodology set out in the draft tariff code is compatible with the common tariff requirement.

2.7. In theory the auction process required by CAM could result in a different clearing price for capacity at Moffat compared to Gormanston which would not be consistent with a common tariff. However the reconciliation process can be

² Substituted by regulation 41 of the Gas and Electricity (Internal Markets) Regulations (Northern Ireland) 2011 (S.R. 2011/155).

designed to maintain the common tariff and our proposals are set out in section 5 and further explained in section 7.

Key features of postalisation

- 2.8. The postalised charging regime is based on an exit point payment mechanism where suppliers pay the postalised capacity and commodity charges based on their booked capacity and volumes transported only at the point where they exit the transmission network. A supplier will not have to pay the tariff when it exits pipelines which it is transiting through (e.g Coolkeeragh gas transiting through the PTL and BGTL pipelines). Therefore a key relationship in postalisation is between the supplier and the operator from whose pipeline that supplier exits the postalised network.
- 2.9. The postalised capacity and commodity tariffs are charged to all users at their exit point irrespective of where they exit or what pipelines they use. Consequently all users contribute to all high-pressure pipelines.
- 2.10. In the postalised system charges are set to recover the required revenues of the TSOs. Revenue transfers occur between the TSOs to equalise the payments they receive with their revenue requirement.
- 2.11. The TSOs are not exposed to either capacity or volume risk as shippers pay their proportion of the required revenues based on their actual volumes/capacity at the end of the year. Similarly bad debt is to be recovered, ultimately from all gas suppliers. The inability of one group of customers to contribute to cost recovery would therefore result in a transfer of costs onto the remaining customer groups.
- 2.12. Under or over recovery of revenue is dealt with by a reconciliation mechanism at the end of each year. The reconciliation process generates a

single ('bullet') payment each year to/from shippers based on their actual volumes/capacity at the end of the year. This ensures that the TSOs' total required revenue is recovered from customers who use the network in that year. To inform suppliers of the likely magnitude of the end of year reconciliation, actual volumes are circulated each quarter by the TSOs.

- 2.13. An over/under recovery of required revenues at the end of the year will most likely be caused by actual annual volumes and capacity bookings turning out different from the start of the year forecasts.

Underwriting of PTL and BGTL pipelines

- 2.14. It should be noted that the PTL and BGTL pipelines have both been mutualised since 2004. As part of both mutualisations NI gas users continue to underwrite the SNIP and BGTP in return for significant savings in the form of a reduced cost of capital and so reduced costs for gas users. The postalised charging and payments system forms the basis of the guarantee for PTL's and BGTL's revenues.
- 2.15. The postalised structures ensure that PTL's and BGTL's actual required revenues are recovered from all gas customers. In particular the depositing of all payments from shippers into a bank account held in trust (the PoT), and the end of year reconciliation which ensures that PTL's and BGTL's actual costs are recovered from all users. This, in practice, means that all NI gas users pay for SNIP and BGTP in all circumstances, including, for the avoidance of doubt, the cost of other users' non payment of tariffs, if any. In order to ensure that all NI customers continue to underwrite SNIP and BGTP the new process will need to ensure that any under recovery of PTL/BGTL actual required revenues will be recovered from all gas customers.

Financial and legal structures underpinning postalisation

2.16. The current postalised system has a number of distinct features including a detailed financial structure which ensures that each TSO receives its allowed costs through the collection of a common tariff. This complexity is necessary to manage the exit point payment mechanism, to mitigate the risk to revenue transfers between the TSOs, and to mitigate the risks to shippers of bad debt. These features include:

- A bank account held in trust (the PoT) into which all postalised transmission charges and debt recoveries are paid and distributions made to each of the TSOs and in the event of an over recovery via the TSO to suppliers.
- A Postalised System Administrator (PSA) to administer the Postalised system, e.g. to calculate forecast Postalised charges, calculate the Year-End Postalised Charges and any Capacity Reconciliation Payments and Commodity Reconciliation Payments, and verify payments into the PoT Account.
- A shipper credit committee to manage debt and credit issues

2.17. A detailed legal structure also underpins postalisation in NI, composed of:

- Detailed postalisation licence conditions in Part 2A of each high pressure licence
- Common network code rules at transmission level – in particular relating to invoicing and credit which covers suppliers providing credit security for their postalisation payments and the procedures for dealing with non-payments on the system, the alignment of invoicing cycles and information provision requirements
- Contracts to facilitate postalisation including:

- The Designated Pipeline Operators Agreement. This agreement is required by the licenses and covers issues relating to Postalised charges, the creation of a management committee for the Postalised system, appointment of the PSA and the trustee and bank account.
- The Postalised System Administration Agreement (PSAA) under which the TSOs appoint a third party as the Postalised System Administrator (PSA) to administer the Postalised system, e.g. to calculate forecast Postalised charges, calculate the Year-End Postalised Charges and any Capacity Reconciliation Payments and Commodity Reconciliation Payments, and verify of payments into the PoT Account.
- Trust and Account Bank Agreement (TAB) which establishes and governs the operation of the PoT.

Summary of current postalisation processes

2.18. At the beginning of the gas year the forecast transmission tariffs (capacity and commodity) are determined. There are four key elements needed for the tariffs – the total required revenues of the TSOs, the total capacity booked on the transmission system, the forecast volumes, and the proportions of revenues to be recovered from capacity and commodity respectively. We currently apportion 75% of the revenues to capacity charges and 25% to commodity.

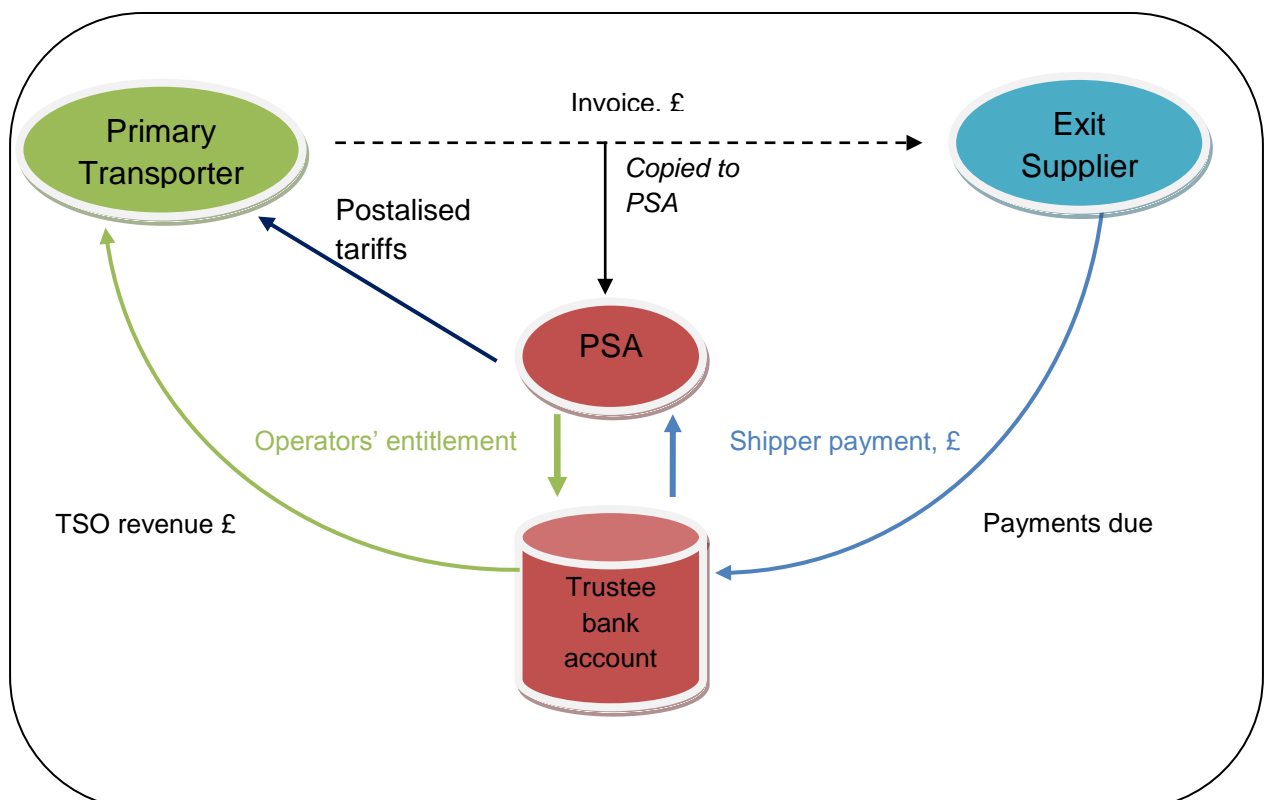
2.19. The required revenue apportioned to capacity is then divided by the forecast capacity bookings for the forthcoming gas year to give a forecast postalised capacity tariff. Similarly the required revenue apportioned to

commodity is divided by the forecast commodity flows for the forthcoming gas year to determine a forecast postalised commodity tariff.

2.20. During the year each shipper will receive invoices for their postalised capacity and commodity charges from the TSO from whose network that shipper exits. The shipper pays the postalised charges into the PoT bank account from which monthly distributions are made to the TSOs by the PSA. At the end of the year actual volumes and capacity booked are communicated to the PSA by the TSOs together with PTL's and BGTL's actual required revenue calculated in accordance with its licence. The PSA then calculates the end of year capacity and commodity charges and determines any capacity/commodity reconciliation bullet payments. The reconciliation payments are then included in the invoice issued in December of the next gas year.

2.21. Figure 1 below demonstrates the current process

Figure 1 Overview of current postalisation process



Summary of key features of postalisation

- Common tariffs for designated pipelines as required by legislation
- Exit point payment mechanism – shipper relationship is with the TSO at the exit point
- Shipper payments go into a bank account held in trust (PoT) and there is a PSA to administer the process
- Revenue transfers between the TSOs to and from the PoT
- TSOs are not exposed to capacity or volume risk as shippers pay based on their actual volumes/capacity at the end of the year
- Under or over recovery is dealt with by end of year reconciliation
- Bad debt ultimately recovered from all gas suppliers – credit committee to manage this
- PTL and BGTL actual costs are recovered via the end of year reconciliation thus facilitating the underwriting of MEL pipelines by all gas users
- Detailed legal and financial structure underpins the postalised system in the form of licenses, network codes, contracts and other financial arrangements, e.g. for the PoT to be held in trust.

3. Summary of EU requirements to be implemented in 2015

The Gas Regulation - requirements in respect of tariffs

3.1. The Gas Regulation contains a number of new obligations in respect of tariffs.

Article 13 explicitly states that ‘tariffs ... shall be set separately for every entry point into or exit point out of the transmission system’.

3.2. The implementation of this requirement requires that the concept of entry capacity is introduced into the transmission codes in Northern Ireland and that a corresponding tariff is developed for entry capacity.

3.3. Article 13(1) and 13(2) of the Gas Regulation, states that tariffs and the methodologies used to calculate them, are required to:

- Be transparent;
- Reflect actual costs incurred;
- Be applied in a non-discriminatory manner;
- Facilitate efficient gas trade and competition;
- Avoid cross-subsidies between shippers; and
- Avoid distorting trade across borders of different transmission systems.

Network codes required by the Gas Regulation

3.4. Separately the Gas Regulation requires a number of European network codes (EUNCs) to be agreed. The objective of the EUNCs is to harmonize rules for the flow of gas across the European Union, particularly with respect to cross-

border network issues and market integration, and to ensure the application of the principles of non-discrimination, effective competition and efficient functioning of the market.

3.5. Two of these codes in particular impact on the manner in which NI will introduce entry capacity into the postalised system - the EUNC on Capacity Allocation Mechanisms³ (CAM) and the EUNC on harmonized tariff structures for gas.⁴

3.6. As stated above, the proposals in this paper therefore do not cover implementation of each aspect of the draft network code on tariffs; we will consult on implementation of the tariff code in late 2015/early 2016 once the code has been agreed. However, in formulating proposals for the introduction of entry charges, we have taken account of the draft tariff code where it seems sensible to do so, e.g. the draft rules on methodologies which define rules for cost allocation between entry and exit points, the setting of reserve prices, and reconciliation arrangements.

The CAM code

3.7. The CAM code requires TSOs to offer a number of capacity products - yearly, quarterly, monthly, daily and within day capacity. These products must be offered at Interconnection Points (IPs)⁵ by November 2015.

3.8. In practical terms this means that CAM will be implemented at the system

³ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:273:0005:0017:EN:PDF>

⁴ http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Framework_Guidelines/Framework%20Guidelines/Framework%20Guidelines%20on%20Harmonised%20Gas%20Transmission%20Tariff%20Structures.pdf

⁵ IPs are defined in the CAM code as 'a physical or virtual point connecting adjacent entry-exit systems or connecting an entry-exit system with an interconnector, in so far as these points are subject to booking procedures by network users.'

entry points which may be booked by network users, i.e. Moffat and Gormanston. The CAM products will therefore be offered by the TSOs at these points (PTL at Moffat and BGE(NI) at Gormanston).

3.9. There is no requirement to offer CAM products at the NI exit points and we do not propose to do so for November 2015. Any changes we propose to make at exit for 1 October 2015 are set out in section 6.

3.10. CAM also requires that capacity is allocated by means of auctions and sets out detailed rules for the auction methodology. In theory the auction process could result in a different clearing price for capacity at Moffat compared to Gormanston which would not be consistent with a common tariff. However, we propose that the reconciliation process can be used to ensure the same end of year unit charge for capacity and this is considered further in section 5.

3.11. Article 21 of the CAM NC requires that TSOs shall offer a daily capacity product for interruptible capacity at IPs where firm capacity has been offered but was sold out day-ahead. TSOs may offer interruptible capacity products of longer duration as well. However it is unlikely that day ahead firm capacity will be sold out in 2015. For these reasons we have not yet developed an interruptible tariff at entry. We propose that this can be considered if circumstances change.

EUNC on harmonized tariff structures for gas

3.12. The Gas Regulation prescribes that a code on tariffs must be agreed containing rules 'regarding harmonised transmission tariff structures'. As set out above ENTSOG published a draft network code on 28 May 2014. The likely date for implementation of the new tariff rules is 1 October 2017.

3.13. The draft tariff code states that the new rules apply to IPs and that certain

sections of the rules will also apply to points other than IPs. In effect this means that the tariff code will apply in its entirety to the Moffat and Gormanston entry points, and that the following sections of the code will apply at the NI exit point – the general provisions of the code, the cost allocation approach, publication requirements, revenue reconciliation, and final and transitional provisions.

Entry charging in NI and the draft tariff network code

3.14. We have outlined briefly below the key elements of the draft tariff network code which impact on the introduction of entry capacity in Northern Ireland. Our proposals in respect of each are set out in the next chapter.

3.15. Cost allocation approach and methodology – in the draft tariff code the cost allocation approach means the application of a capacity-commodity split to transmission revenue. The draft code does not define a precise capacity-commodity split but states that the purpose of the commodity charge shall be to cover ‘the costs mainly driven by the quantity of the gas flow.’⁶

3.16. The cost allocation methodology is then applied to the capacity portion of the revenue in order to determine the allocation of cost to the various entry and exit points on the network. Only one primary cost allocation methodology may be applied, complemented, if necessary, by one or more secondary adjustments. The draft tariff code specifies four primary cost allocation methodologies (plus two variants):

- Postage stamp
- Capacity-Weighted Distance
- Virtual point based approach (Variants A and B)

⁶ See Article 4(4)(b) of the draft Tariff code.

- Matrix approach

- 3.17. In relation to the introduction of entry capacity in NI, we must decide the capacity-commodity split at entry and exit points, and which cost allocation methodology to apply. In section 5 below we set out our proposal to apply the postage stamp methodology together with the current capacity-commodity split to both entry and exit points.
- 3.18. Split of revenues between entry and exit - One of the parameters of the cost allocation methodologies is the split between entry revenue and exit revenue. This entry-exit split may be either an input to or an output of the cost allocation methodology. If the entry/exit split is to be an input then the proportion of revenue to be collected at entry and exit respectively will be defined in advance. If not defined in advance the entry-exit split is an output from the reconciliation process.
- 3.19. In section 5 we propose that the revenue split between entry and exit points should arise from reconciliation, as an output from the application of the postage stamp methodology.
- 3.20. Reserve Price Calculation - The code includes rules on how reserve prices for standard capacity products with a duration of less than one year, will be derived including the determination and use of multipliers and seasonal factors.
- 3.21. In relation to the introduction of entry capacity in NI we must calculate reserve prices for the CAM products for the first CAM auctions in 2015. The tariff code will not apply at that point. However, it makes sense to take account of the reserve price calculation in the tariff code and the rules on the application of multipliers and seasonal factors in the new NI approach.
- 3.22. Revenue Reconciliation – the code sets out rules on tariff reconciliation with a view to promoting financial stability of the TSOs and stability of tariffs

such that significant differences from one tariff period to the next can be avoided. The TSO will have a regulatory account which will be reconciled periodically in line with the decisions of the National Regulatory Authority (NRA) involved. The NRA may decide to introduce a separate account for the auction premium, if any is to be retained by the TSO. We do not envisage a separate account for the auction premium; we propose that any premium will be dealt with as part of the reconciliation process and returned to customers.

Summary of EU requirements to be implemented in 2015

- The inclusion of entry capacity in the NI tariff regime
- Entry capacity to be offered as yearly, quarterly, monthly, daily and within day capacity. Therefore the new tariff methodology needs to generate tariffs for these products
- Entry capacity to be auctioned. Therefore the tariff methodology needs to consider how auction reserve prices will be set and take account of the clearing price from the auctions, deal with over/under recovery of revenues etc.
- The EU network code on tariffs does not need to be implemented until 2017. However, in devising proposals for the new entry tariff methodology for 2015, we propose to take account of the draft tariff code where it seems sensible to do so.

4. Considerations in the design of the new tariff regime

4.1. We consider that the new entry tariff regime should meet a number of requirements and we would welcome views on these.

4.2. Implement European Legislative requirements: the new tariff arrangements will need to be fully compliant with Article 13 of Regulation (EC) 715/2009 (Tariffs for access to networks). They will also facilitate the introduction of the new CAM capacity products and the requirement for auctions. As noted the tariff network code is in draft format and is yet to be finalized. NI will eventually need to meet the requirements of the tariff code; therefore we would wish to introduce entry capacity using one of the cost allocation methodologies in the draft code. We believe these methodologies are unlikely to change significantly before the code is agreed but we will continue to input into European discussions on the tariff code in order to minimize the risk of divergence between the code and the NI 2015 regime.

4.3. Implementation by October 2015 As explained in section 3 the concept of entry capacity (including all the new CAM capacity products) and the associated tariffs must be introduced in NI by 1 October 2015. We consider that this is most easily accomplished by building on the current postalised arrangements in NI. Moving away from postalisation would require a change in government policy and legislative change. Also the cost allocation methodologies which would be necessary to introduce locational charging do not seem best suited to NI given its size and are complicated to design. For these reasons we consider that meeting the 2015 deadline is best accomplished by introducing entry charges in a manner consistent with the

current postalised structure required by legislation

4.4. Consistent with the common tariff requirement As discussed above, the existing postalised arrangements are based upon a 'common tariff' which is set out in primary legislation. We would wish to work within the existing 'common tariff' requirements in NI legislation where this is compatible with European legal requirements.

4.5. Maintain underwriting of Mutual Energy Ltd pipelines The arrangements agreed as part of the mutualised financing of the SNIP and BGTP must be maintained within the new tariff regime. See section 2 for a description of how the current postalised arrangements ensure the underwriting of the PTL and BGTP pipelines.

Underwriting of BGE(NI) pipelines in the new tariff regime

4.6. Unlike PTL/BGTL no commitment to underwrite the BGE(UK) pipelines exists.

4.7. Whether BGE(UK) revenues should be guaranteed at their current rate of return is something that we will wish to consider in parallel with decisions on the new charging regime. Discussions on the regulatory model and risk allocation are ongoing with BGE(UK).

4.8. This issue should not affect the overall design of the new tariff structure.

Q1: We welcome views on the requirements for the new entry tariff methodology set out in section 4.

5. Entry charging in the NI postalised regime

5.1. In section 3 above we outlined briefly the elements of the draft tariff network code which impact on the introduction of entry capacity into the NI postalised tariff regime. This section considers each of these elements in further detail and covers:

- Cost allocation method between the points on the network
- Capacity commodity split at entry and exit
- Split of revenues between entry and exit
- Reserve price calculation
- Multipliers/seasonal factors for non-annual products
- Reconciliation process

Cost allocation methodology

5.2. The draft tariff network code specifies four primary cost allocation methodologies:

- Postage stamp
- Capacity-Weighted Distance
- Virtual point based approach (Variants A and B)
- Matrix approach

5.3. We briefly explain each of these methodologies below with reference to the common tariff requirements in legislation. Our proposal is to apply the postage stamp methodology for the reasons set out below.

Postage stamp

- 5.4. The postage stamp methodology foresees the same reference price at all entries and the same reference price at all exits. In other words the output of this methodology is one uniform tariff at entry and one uniform tariff at exit. The tariff for entry points can be the same or different from the exit points.
- 5.5. This methodology is the simplest of those available in the draft tariff code. The required inputs are the allowed revenue, the revenue split between entries and exits and the assumptions on capacity bookings. The reference price for each category of points is given by the target revenue for entry (respectively exit) divided by the total booked capacity (or a relevant proxy) which is assumed for entry points (respectively exit points).
- 5.6. As set out in the Framework Guideline on tariffs, the postage stamp methodology may be applied where;
- A significant majority (at least 2/3) of the transmission capacity is dedicated either to the domestic market or to the cross-border gas flows or
 - The difference between the average distance travelled by cross-border flows and the average distance travelled by domestic flows does not exceed a threshold to be determined in the Network Code on Tariffs.
- 5.7. In the case of Northern Ireland, 100% of the transmission capacity is dedicated to the Northern Ireland market and there are no cross border flows. Once gas physically enters the NI market, gas cannot physically leave NI. Therefore the NI network meets the criteria for the application of a postage stamp methodology.

Capacity weighted distance

- 5.8. This methodology aims to ensure that the share of the allowed revenue to be collected from each point (and thus the tariffs) should be proportionate to its contribution to the cost of the capacity of the system.
- 5.9. The cost drivers for this methodology therefore are capacity and distance. It requires the distance between each of the points to be calculated and the point is then weighted by the technical capacity of the point. The allowed revenue is then allocated proportionately to each point with no requirement for rescaling. A worked example of this methodology has been published by ENTSOG in its supporting document for the draft tariff network code.⁷
- 5.10. The output of this methodology will be different tariffs at each entry and exit point which would not be consistent with the common tariff requirement.
- 5.11. In addition while this approach may be considered as being more cost-reflective than the Postage Stamp methodology (as it introduces distance and capacity as cost drivers into the cost allocation process), we do not have any concerns with the cost reflectivity of postage stamp charges given the small size of the NI network.
- 5.12. The application of this methodology would also require the collection of more data to determine the cost of capacity at individual points on the system. We envisage that the costs would be disproportionate to the additional benefits of implementing these arrangements.
- 5.13. For these reasons we propose not to apply the capacity weighted distance methodology in NI.

⁷ See Annex 1 – Cost Allocation Methodology Examples http://www.entsog.eu/public/uploads/files/publications/Tariffs/2014/TAR300-14_Initial%20Draft%20TAR%20NC%20Supporting%20Document_for%20consultation.pdf

Virtual point based approach (Variants A and B)

- 5.14. The principle of the virtual point based approach is to determine entry and exit tariffs for each point to which the tariff applies by weighting capacity at these points according to their distance to a virtual point. The 'virtual point' (theoretical location) can be either adjusted for mathematically (Variant A) or determined geographically (Variant B).
- 5.15. As with the capacity weighted distance approach the output of this methodology will be different tariffs at each entry and exit point which would not be consistent with the common tariff requirement. Additionally, this methodology is more complicated than either of the previous models. We envisage that the costs would be disproportionate to the additional benefits of implementing these arrangements.
- 5.16. For these reasons we propose not to apply the virtual point based approach in NI.

Matrix approach

- 5.17. Under this option, the entry and exit capacity charges result from an optimisation process, which minimizes the difference between network charges paid by users and the costs allocated to the individual entries and exits. It may be considered to give strong locational signals as it is based on a unit cost between all combinations of entry and exit points.
- 5.18. Again the output of this methodology will be different tariffs at each entry and exit point which would not be consistent with the common tariff requirement. In addition we consider that the complexity of this approach is not appropriate in NI. This complexity can be seen from a worked example of this methodology which has been published by ENTSOG in their supporting

document for the draft tariff network code.⁸ We therefore do not propose to apply it in NI.

Table 1: Overview of the Cost Allocation Methodologies

Cost Allocation Methodology	Inputs	Outputs
Postage Stamp Approach	Revenue and Capacity	Equal Tariffs
Capacity Weighted Distance Approach	Capacity, Distance and Revenue	Differentiated Tariffs
Virtual Point Based Approach	Capacity, Distance, Network Representation, Virtual Point (theoretical or geographical), Flows and Revenue	Differentiated Tariffs
Matrix Approach	Capacity, Distance, Network Characteristics, Flows, Costs and Revenue	Differentiated Tariffs

⁸ See Annex 1 – Cost Allocation Methodology Examples http://www.entsog.eu/public/uploads/files/publications/Tariffs/2014/TAR300-14_Initial%20Draft%20TAR%20NC%20Supporting%20Document_for%20consultation.pdf

Initial proposal on the cost allocation methodology

- 5.19. In the NI context, the key question is whether any of the methodologies are compatible with the common tariff requirement. A further question is whether any of the methodologies are proportional to the NI market which is a small, relatively simple market.
- 5.20. Of the four options above only the postage stamp methodology foresees the same reference price at all entries and the same reference price at all exits. It is therefore compatible with the common tariff requirement.
- 5.21. We also consider that the size and nature of the high pressure network means that postage stamp methodology is sufficiently cost reflective.
- 5.22. If we wished to apply another methodology it may be possible to design the reconciliation process to result in a common tariff but this would go against the intent of these methodologies.
- 5.23. For this reason we propose to apply the postage stamp methodology in NI.

Q2: We welcome views on our proposal to apply the postage stamp cost allocation methodology

Capacity-commodity split between entry and exit

- 5.24. The capacity-commodity split refers to the allocation of capacity and commodity charges to determine the respective gas transmission tariffs. The existing capacity-commodity split in Northern Ireland is 75:25 for the high-pressure network. Therefore the split is currently effectively the same at entry and at exit.
- 5.25. The EUNC on tariffs will contain rules on the capacity commodity split

applicable from 1 October 2017. The draft code indicates that commodity charges may be applied for the purposes of recovering variable costs driven by the volume of gas flowed. An assessment of variable costs driven by gas flows will therefore need to be done for the 2017/2018 tariff year. However, there is no requirement to change the existing capacity commodity split in 2015.

Initial proposal on the capacity- commodity split

5.26. As set out above, the future EU rules on the capacity commodity split will be set out in the tariff code which is still under development and in any event will not need to be implemented until 2017. Consequently, there is no requirement to change the current capacity commodity split in 2015.

5.27. In order to manage any uncertainty around the precise drafting of the EUNC on tariffs our initial proposal is to maintain the current 75:25 split at exit and at entry for 2015. When the EUNC on tariffs is agreed we will then consider whether the current capacity-commodity split is compatible with the EUNC and consult on any changes that may be necessary for 2017 implementation.

Q3: We welcome views on our proposal to maintain the current 75:25 split at exit and at entry for 2015 but to revisit this again for 2017 once the EUNC on tariff is finalised.

Split of revenues between entry and exit

5.28. The entry-exit split may be either an input to or an output from the cost allocation methodology.

5.29. If applied as an input then the proportion of revenue to be recovered from entry needs to be decided in advance.⁹ If the split is an output it effectively results from the reconciliation process and therefore is a feature of that process.

5.30. We propose that the revenue split between entry and exit points should arise from reconciliation, as an output from the application of the postage stamp methodology. Therefore prices would be derived from total revenues divided by total forecast capacity (at entry and exit) and the output will be prices that are the same at the entry and exit points. An illustration of this is set out in the table below. The figures in the table have been derived from the information provided by the TSOs for the calculation of the 2014/15 postalised tariff.

Table 2: Illustration of the entry-exit split as an output from reconciliation

Inputs	
TSOs Required Revenue	£49,700,997
Entry Capacity	75,000,000 ¹⁰ kwh/day
Exit Capacity	82,810,945 kwh/day
Entry- Exit Split	Unknown
Calculation	
Total Capacity	75,000,000 + 82,810,945 = 157,810,945
Tariff	£49,700,997/157,810,945
Entry Tariff	£ 0.31494 kwh/day
Exit Tariff	£ 0.31494 kwh/day
Result	
Entry-Exit Split	48:52 (75,000,000/157,810,945):(82,810,945/157,810,945)

⁹ Where the entry exit split is an input the rules in the draft code are more prescriptive. The draft states that the default entry-exit split shall be 50/50. However, the regulatory authority may decide to apply an entry-exit split other than 50/50 but this must be based on cost drivers such as distance, technical capacity or forecasted contracted capacity, and better fulfil the objectives such as not creating barriers to cross-border trade and avoiding differences between the allowed revenue and the actually obtained revenue.

¹⁰ This is an assumed weighted figure which includes annual entry capacity and short term entry capacity

- 5.31. From the review of the features of postalisation set out in section 2 it is clear that the total postalised system required revenues are recovered from all gas users through the reconciliation process. To put this another way the postalised system is based on the principle that all gas users share any risks arising when forecast volumes/capacity differ from actual volumes/capacity and share the risk that PTL/BGTL actual required revenues may differ from forecast.
- 5.32. Therefore in order to ensure that any risk continues to be spread among all gas users it may not be appropriate to limit the amount of revenue recovered at either exit or entry by setting the entry/exit split in advance and maintaining this through the reconciliation. We consider that the need to ensure that PTL/BGTL revenues continue to be underwritten by all gas customers is a strong argument in favor of not determining an ex ante entry exit split.
- 5.33. The sharing of risks among all gas users would also blunt the impact of any deviations from forecast on the end of year bullet payment. At exit where firm annual capacity will be offered we expect that actual capacity booked at exit is likely to be similar to forecast thereby limiting the impact of any deviations from forecast on the end of year bullet payment. However, at entry a range of new products will be offered and it may be difficult for suppliers to forecast their use of these new products. More volatility in actual capacity booked for each product may therefore be expected increasing the possibility of larger end of year bullet payments. Any volatility is therefore likely to be driven by suppliers at entry and to this extent it may be reasonable to expect them to take the risk associated with this. However, this is not the basis of the current postalised system.
- 5.34. Volatility is essentially a forecasting issue. Over time as suppliers avail of

the new products at entry we would expect forecasts to better match actual use of the various products however forecasting risk cannot be eliminated.

Initial proposal on the entry-exit split

5.35. Our initial proposal is that an ex ante entry-exit split is not in keeping with the current postalised system for the reasons set out above, therefore the entry-exit split should be an output from the reconciliation process.

Q4: We would welcome views on our proposal that the entry-exit split should be an output from the reconciliation process.

Reference price calculation

5.36. The reference price refers to the price for the yearly standard capacity product for firm capacity applicable for entry and exit points derived in accordance with the cost allocation methodology.

5.37. Determining the reference price is a straightforward process once the cost allocation methodology, entry-exit split (whether ex-ante or ex-post) and the capacity-commodity split are decided upon. Once these are agreed, calculation of the reference price is essentially a matter of inputting the data into largely existing formulae along with the forecast capacity/volume information. The proposed process to calculate the reference price is set out in detail in section 7.

5.38. The application of multipliers and seasonal factors is then used to calculate the reserve price for non-annual capacity products (see discussion of multipliers and seasonal factors below).

- 5.39. We will need to consider the timing of when these calculations will be carried out and tariffs published. Unless the tariff code mandates otherwise we propose to apply the current timings in use for postalisation where the calculation of the postalised tariff process starts at the end of June and tariffs are published in early August.
- 5.40. Therefore the reference and reserve prices set during the postalised price setting process in the summer of 2015 will apply for the first CAM auctions for daily and monthly capacity commencing in November 2015 and for the first auctions for annual capacity in March 2016 and quarterly capacity in June 2016.
- 5.41. If we are to maintain the common tariff we will need to have the same charge at each entry point i.e. Gormanston and Moffat are charged for separately but at prices set at the same tariff. Auctions at Gormanston and Moffat will therefore be based on the same reference price and the same multipliers will be applied to products at these points. However, capacity at these points will be auctioned separately so in theory (assuming Gormanston is used) the clearing price from each auction could be different.
- 5.42. From a practical perspective, given that Gormanston is not currently used and there is no constraint at Moffat, we would expect that the auction price would be the reserve price i.e. there is no change and the Gormanston and Moffat entry tariff remain the same. However where this is not the case we propose that the reconciliation process will result in an adjustment which will ensure the common tariff. This is explained below and in section 7.

Multipliers and seasonal products

Multipliers:

5.43. The draft tariff network code defines ‘multiplier’ as the factor applied to the respective proportion of the reference price in order to calculate a reserve price for a non-yearly standard capacity product.

5.44. The draft code specifies that the reference price for quarterly, monthly and daily standard capacity products are calculated in accordance with the following formula:¹¹

$$P_{st} = M \times (P_y / 365) \times D$$

Where:

P_{st} is the reserve price for the respective short term (st) capacity product;

M is the level of the multiplier corresponding to the respective standard capacity product;

P_y is the reference price;

D is the duration of the respective standard capacity product expressed in gas days.

5.45. In the absence of congestion M can be 1 (or between 0 and 1.5)

Seasonal factors:

5.46. The draft Tariff Network Code defines seasonal factors as ‘the factor reflecting the seasonal gas flow that may be applied in addition to the relevant multiplier in order to calculate a reserve price for a non-yearly standard capacity product’.

5.47. Notably the definition of seasonal factor states that the seasonal factor

¹¹ There is a further formulae to determine the reserve price for within-day standard products which is not presented here.

may be applied in addition to the relevant multiplier. Seasonal factors may apply to quarterly, monthly, daily and within-day products.

5.48. Seasonal factors shall only apply if they improve the gas transmission system's efficient use and cost reflectivity of reserve prices. When seasonal factors are applied in addition to multipliers, the combination of multipliers and seasonal factors for any standard capacity product with a duration of less than one year may for some seasons be higher than 1.5 or lower than 0.5. However, the arithmetic mean of the products of multipliers and seasonal factors shall over the gas year not be lower than 0.5 and shall not exceed 1.5.

5.49. The draft code specifies that where seasonal factors are applied, the reserve prices for firm capacity shall be calculated in accordance with the relevant formulas for the calculation of short term products with multiplication by the respective seasonal factor. The relevant formula is:

$$P_{st} = M \times (P_y / 365) \times D \times S_m$$

where S_m is the seasonal factor for the relevant month ($m=1-12$)

5.50. Article 25 (information to be published) of the draft tariff network code states that justification for introducing multipliers and seasonal factors shall be published when used for calculating the reserve prices for non-yearly standard capacity product for firm capacity.

5.51. A table of the possible range of multipliers and seasonal factors is provided below (summary of Article 29). Since the conditions of Article 29 (1) (i.e. contractual congestion and limited available capacity for daily product) are not met at Moffat, the multipliers set out in Article 29 (2b) are applicable.

Table 3: Range of multipliers and seasonal factors in the draft tariff code

Level of Multipliers	
Product:	
Quarterly	No less than 0.5 and no more than 1.5
Monthly	No less than 0.5 and no more than 1.5
Daily	No less than 0 and no more than 1.5
Within day	No less than 0 and no more than 1.5
Level of Seasonal factors	
Where seasonal factors are applied, the arithmetic mean over the gas year of the product of the multiplier applicable for the respective standard capacity product and the relevant seasonal factor shall be no less than 0.5 and no more than 1.5.	

5.52. Additionally, draft Article 29(5) states that, ‘subject to the decision of the national regulatory authority, the level of the multipliers may be more than 1.5 where the transmission system operator or the national regulatory authority, as relevant, justifies that the resulting reserve prices better correspond to Article 28(5). If the multiplier is greater than 1.5, the arithmetic mean of the multiplier and seasonal factor is still limited to the range stated in table 3 – no less than 0.5 and no more than 1.5.

5.53. ENTSOG has considered the issue of multipliers and seasonal factors in some detail and we believe that this is one area of the draft code where changes to the current text are likely.

Discussion of the options in relation to multipliers and seasonal factors

- 5.54. The role of multipliers is to mitigate the risk of under recovery of TSO revenue while also making short term capacity available for use. Therefore multipliers could be used to sharpen the prices for short term capacity at times when demand on the network is expected to be greater e.g. higher multipliers in winter periods.
- 5.55. The role of seasonal factors is to ensure the revenue from provision of the marginal unit of capacity (in winter) is sufficient to recover the cost of provision of that capacity for the full year. Therefore seasonal factors are useful in ensuring revenue recovery from suppliers using more capacity in winter than in summer. Seasonal factors can also play a role in incentivizing suppliers to manage demand away from the peak day although this works best if storage is available.
- 5.56. The draft tariff code would permit us to apply no multipliers or seasonal factors, to apply multipliers only or to apply a combination of multipliers and seasonal factors. If no multipliers are applied then the price of daily capacity in each day of the year would simply be the price of annual capacity divided by 365 (or 366 in a leap year).
- 5.57. We already apply an approach akin to seasonal factors to the existing daily capacity product in order to incentivize use of the network in summer and would wish to maintain this approach at entry. Therefore we are minded to apply either seasonal factors or a combination of multipliers and seasonal factors.
- 5.58. In considering where to set multipliers/seasonal factors the general provisions Article 28 (5) of the draft code are relevant and require that NRAs take into account:

- The balance between facilitating short-term gas trade and providing long-term signals for efficient investment in the transmission system;
- The need for an effective revenue recovery mechanism through incentivising the network users to contract both short-term and long-term services;
- The need to avoid cross-subsidisation between network users and to enhance cost-reflectivity of reserve prices.

5.59. In setting multipliers and seasonal factors, the risk is that low multipliers combined with under forecasting of capacity bookings by suppliers will result in an under recovery of allowed revenues. While the system of reconciliation payments means that the TSOs should be revenue-neutral overall this would impact on TSO cash flows. For suppliers the risk is that large bullet payments may result, affecting market participants' cashflows.

5.60. In order to mitigate these risks, we are minded to make full use of the flexibility to set multipliers and seasonal factors. Therefore the price of capacity is highly likely to be higher in winter than in summer. This will also help to:

- incentivize suppliers to make more use of the network in summer;
- shift demand away from the winter peak, thereby requiring a smaller network than would otherwise be the case; and
- ensure that tariffs reflect the costs of providing capacity to meet peak demand as this is the basis on which the network has been built.

Initial proposal in respect of multipliers and seasonal factors

5.61. We propose to make full use of the flexibility to set multipliers and seasonal factors such that we incentivize suppliers to make more use of the network in summer and shift demand away from the winter peak.

Q5: We welcome views on our proposal to make full use of the flexibility to set multipliers and seasonal factors.

Revenue collection and reconciliation process

Commodity charge

5.62. If there is no ex ante entry exit split the commodity charge would recover 25% of the overall required revenues. In this case it could continue to be billed at exit points and there would be no change to how this charge is collected, deposited into the PoT, or how the revenues are disbursed between the TSOs and reconciled. This is our proposed outcome.

5.63. However if we apply an ex ante entry exit split then the commodity charge will differ between entry and exit and will need to be billed separately at entry and at exit. We envisage that the revenues collected would also be deposited into the PoT and the revenues disbursed between the TSOs and reconciled according to their licenses.

Revenue collection at exit

5.64. We are not proposing any change to how revenues are collected at exit –

therefore the arrangements for billing at exit will remain as they are. Revenues collected at exit for both capacity and commodity will be deposited into the PoT by the relevant TSO and will be disbursed between the TSOs according to their licence requirements.

Revenue collection at entry

- 5.65. For entry, we propose that the approach to revenue recovery and reconciliation should be based on the current processes where possible.
- 5.66. We assume that each TSO will bill for their respective entry point i.e. PTL bill for Moffat entry and BGE(UK) bill for SNP. Payment of charges at entry will be made into the PoT from which they will be distributed in proportion to each TSO's required revenue according to their licences. This arrangement has worked satisfactorily and is well understood by market participants. It would seem appropriate to continue this arrangement under an entry/ exit regime.
- 5.67. Our initial view is to retain a single PoT for holding revenues from both entry and exit. We do not see the need to have separate bank accounts i.e. one for entry and one for exit. The fact that invoices are being paid for services at entry and exit points (and over a number of capacity products with varying timeframes) should not be an impediment to the use of a single account.
- 5.68. The draft tariff code states that each TSO is allowed to use only one regulatory account for aggregating the under- and over-recovery originating from all the entry and exit points. The regulatory account will be reconciled periodically in line with the decisions of the national regulator (NRA) involved. The NRA may decide to introduce a separate account for the auction premium, if any is to be retained by the TSO.

5.69. Our initial view is that the draft code does not preclude the PoT being the regulatory account for each TSO and there is no requirement for multiple accounts in the NI context. Therefore, we propose to retain a single PoT for holding revenues from both entry and exit.

Q6: We welcome views on the proposal to retain a single PoT for holding revenues from both entry and exit.

Reconciliation

5.70. The current reconciliation process is set out in chapter 2 above. The process deals with under or over recoveries so that the total postalised required revenues are recovered from all gas users based on their actual volumes/capacity at the end of the year. Currently capacity bookings are predictable and where actual figures differ from forecasts this is more likely to be due to the volume of gas flow (i.e. end user demand) differing from forecast. Consequently, the end of year bullet payments do not tend to be extreme.

5.71. We have two broad options: –

- Reconcile entry and exit separately such that any under recovery at entry would be recovered only at entry and would not be recovered from exit point charges. Similarly under recovery at exit would be recovered only at the exit point.
- Alternatively reconcile both together so that any risks are shared by all suppliers collectively. This is the principle on which the postalised system is based.

5.72. The choice between these options is also linked to the question of the entry – exit split. If a split is applied ex ante then a logical consequence of this

would be separate reconciliation of the entry and the exit points.

5.73. We propose that entry and exit revenues should be reconciled together.

The considerations here are similar to those associated with the entry- exit split - whether there is a concern over large end of year bullet payments and considerations of fairness in how risks associated with the postalised system are shared between those that use it.

5.74. As discussed above in relation to the entry exit split, as we move towards a situation where more non-annual products are available there is a risk of forecasting error resulting in large end of year bullet payments – if suppliers get their forecasts wrong and book less capacity than forecast then the end of year bullet payments for all suppliers will go up as the same overall amount of revenues must be recovered regardless.

5.75. Better forecasting over time should mitigate this risk but it cannot be eliminated given uncertainties in supply and demand caused by the weather and other factors and it may take some time for suppliers to establish accurate forecasts.

5.76. Reconciling all suppliers together would blunt the impact of large deviations in actual capacity booked at entry compared to forecast because there is simply a larger volume across which to spread any under recovery.

5.77. For the avoidance of doubt to protect customers from facing large bullet payments in respect of commodity we intend to retain the current licence drafting¹² which ensures that the maximum that can be recovered from suppliers in the bullet payment will be 15% of their respective commodity payments during the year.

5.78. It should be noted that the tariff network code has not been finalized but the framework guideline on tariffs is clear that the reconciliation of an under

¹² 2A.2.6.3(b)

recovery cannot be targeted at only one or a few entry or exit points in case this exacerbates the problem of over/under recovery. In the case of NI there are two entry points but only one is effectively used. Therefore even if under recovery was reconciled at entry only it would effectively be targeted only at the Moffat point. This would raise the question as to whether this approach would be compliant with the Tariff code (as currently drafted).

Initial proposal in respect of reconciliation

5.79. For the reasons set out above our initial proposal is to reconcile the entry and exit points together. This is in line with the current principle of the postalised regime.

Q7: We welcome views on our proposal to reconcile the entry and exit points together.

Postalised System Administrator (PSA) Arrangements

5.80. The role of the PSA is set out in section 2 above. Our view is that the PSA functions are required in the new tariff regime and therefore will need to be extended to accommodate entry charges including the additional capacity products at entry.

5.81. However our view is that the PSA function does not need to be performed by a third party and we consider that this should be carried out jointly by the NI TSOs once the single NI TSO is established. Licence changes would be required if there is a move to the NI TSOs carrying out the role.

5.82. For the avoidance of doubt this proposal does not affect the continuation

of the Trustee bank account therefore the arrangements for this will stay the same.

Summary of proposals in respect of entry charging in the NI postalised regime

- We propose to implement the postage stamp methodology. This foresees the same reference price at all entries and the same reference price at all exits. It is therefore compatible with the common tariff requirement in Northern Ireland legislation.
- We propose to retain the current 75:25 split at exit and entry. However, when the EUNC on tariffs is agreed we will consult on any changes to capacity – commodity split that may be necessary for 2017 implementation.
- The revenue split between entry and exit points should arise from reconciliation, as an output from the application of the postage stamp methodology. Therefore prices would be derived from total revenues divided by total forecast capacity (at entry and exit) and the output will be prices that are the same at the entry and exit points.
- Calculation of the reference price is essentially a matter of inputting the data into largely existing formulae along with the forecast capacity/volume information.
- We propose to make full use of the flexibility to set multipliers and seasonal factors such that we incentivize suppliers to make more use of the network in summer and shift demand away from the winter peak.
- In line with the postalised regime, it is proposed to reconcile the entry and exit points together.
- We propose that the PSA function should be carried out jointly by the NI TSOs once the single NI TSO is established.

6. Consequential changes proposed to the NI postalised regime at exit

6.1. There is no requirement to offer CAM products and auctions at the NI exit points. Therefore the postalised process at exit can largely remain unchanged in 15/16. For the avoidance of doubt this includes the fact that the GDNs will continue to book transmission exit capacity.

6.2. However, we believe that there are two changes in relation to the regime at exit which it would be appropriate to make for October 2015:

- To remove the daily capacity product at exit.
- To change the charging regime at exit to ensure that a supplier nominating above the level of booked capacity at an exit point will be charged an appropriate rate for capacity in addition to the commodity charge.

6.3. These two changes are discussed further below.

Removal of daily capacity at exit

6.4. A daily capacity product was introduced in NI in 2012. The product was developed to satisfy infringement proceedings against the UK under Regulation (EC) 715/2009 which replaced Regulation (EC) 1775/2005.

6.5. The daily capacity product was effectively introduced at exit as there was no concept of entry capacity in the NI codes. The daily capacity product was not integrated into the postalised regime as to do so would have triggered substantial changes to the TSO licences. Instead, the daily product is currently outside the postalised regime i.e. revenue from daily capacity sales would not

be paid into the PoT or subject to reconciliation.

6.6. With the full introduction of entry capacity into the NI codes a daily capacity product at exit is no longer required to meet EU obligations. We therefore propose that the TSOs should no longer offer this product at exit and intend to ask them to consult on this in conjunction with their forthcoming Code Modification on entry capacity products.

6.7. We propose to consider in 2016 whether any non-annual products should be offered at the NI exit point from 16/17 but will need to balance any priorities arising from ongoing EUNC implementation. Any new exit products would be fully integrated into the postalised regime at that time and we would consult on this.

Q8: We welcome views on discontinuing the daily capacity product at exit from 1 October 2015

Interruptible arrangements at exit

6.8. NI currently offers a daily interruptible product at exit. A gas supplier flowing gas on an interruptible basis pays the transmission commodity charge only. This is because TSO network costs at distribution points are covered by the GDN under an annual capacity charge which is passed on to Shippers.

6.9. However with the introduction of additional short term products at entry all gas users may not contribute to network costs in the same way. Consequently, the current arrangements at exit will need to change to ensure that an appropriate charge is levied on shippers who nominate above the firm capacity booked at an exit point.

6.10. We therefore propose that a supplier nominating above the level of

booked capacity at an exit point will be charged the reserve price for daily capacity in addition to the commodity charge.

6.11. For the avoidance of doubt where the capacity has been booked by a third party (such as a GDN) we wish to ensure that suppliers can flow against that firm capacity booking at the exit point and incur the commodity charge as they do now.

6.12. If agreed the implementation of this principle will require further discussion with the TSOs as part of the code workstream.

6.13. This proposed charge is consistent with the requirements of Regulation 715, Article 14 which states that 'the price of interruptible capacity shall reflect the probability of interruption'. The risk of interruption on the NI transmission network is low such that interruptible has been effectively a firm product; therefore it is appropriate that interruptible capacity is charged at the same price as the daily firm product.

Q9: We welcome views on our proposal that a supplier nominating above the level of booked capacity at an exit point will be charged an appropriate rate for capacity in addition to the commodity charge.

Summary of consequential changes proposed to the NI postalised regime at exit.

- There are two changes in relation to the regime at exit which we believe it would be appropriate to make for October 2015:
 - To remove the daily capacity product at exit.
 - To change the charging regime at exit to ensure that a supplier nominating above the level of booked capacity at an exit point will be charged an appropriate rate for capacity in addition to the commodity charge.

7. Illustrative postalised tariff process

7.1. This section applies our proposals in this paper to provide an illustrative postalised tariff process. As set out in section 5 our preferred approach is to determine an annual capacity tariff across the transmission network to collect total revenues rather than allocating revenues separately between entry and exit. This would result in an annual capacity tariff for the total transmission network, i.e. annual prices that are the same at the entry and exit points. The steps associated with this process are set out below.

Illustrative tariff process

Calculation of the reference price and auction reserve prices

STEP 1: Collect shipper information and set tariff parameters

7.2. Prior to calculating the annual reference price and auction reserve prices the following parameters and inputs are required:

- A. The TSOs' total allowed revenues for the relevant gas year which are calculated in line with their licences
- B. Annual forecast capacity bookings by shippers at entry and exit. Under current arrangements the Gas Distribution System Operators (GDNs) currently book annual exit capacity on the basis of forecasts supplied by gas suppliers. However under the new entry/exit capacity booking arrangements suppliers will book entry capacity based upon their forecast use of annual, short term and interruptible capacity products. GDNs will continue to book exit capacity and the process set up to

facilitate this continues.

- C. Annual forecast commodity flows by individual shipper
- D. The percentage of revenue to be allocated between capacity and commodity charges. As set out in section 5 we are proposing that 75% of revenue is to be collected via the capacity charge and 25% to be collected via the commodity charge
- E. If applicable the percentage of revenue to be split between entry and exit. As noted in section 5 our preference is to calculate a reference price for the entire transmission network rather than splitting the revenues at entry and exit and determining separate entry and exit tariffs.
- F. Seasonal factors are set for each month
- G. Multipliers are set for each of the short term capacity products

7.3. We propose that, where possible (and taking into account the requirements of the tariff code), the timings for shippers to submit the relevant information will be in line with current arrangements. Suppliers are consulted on their forecast capacity and commodity bookings in February with figures submitted to the TSOs in June, to allow for calculation of the forecast tariffs.

STEP 2: calculate the forecast annual capacity tariff and commodity tariff

7.4. The forecast annual capacity tariff is calculated first since this forms the reference price for the calculation of the non-annual capacity products. As with the current arrangements, the tariff will be split between a capacity and commodity charge.

7.5. The formula to determine the annual firm capacity tariff calculated at the beginning of the year would be:

$$\mathbf{Forecast\ Annual\ Capacity\ Tariff = Total\ Forecast\ Required\ Revenues}$$

(allocated to capacity charges) / (Weighted forecast capacity bookings for all products at both entry and exit)

- 7.6. The calculation to determine the annual firm capacity tariff uses weighted capacity because revenues are split by product weighted according to the product's proportion of the TSOs' revenues.
- 7.7. The calculation of the annual reserve price from the annual allowed revenues must use capacity figures weighted by product. This is best demonstrated mathematically, as follows:

Allowed revenue = (annual price x annual capacity quantity) + (annual price x quarterly weightings x quarterly capacity quantities) + ...

Or

Allowed revenue = annual price x (annual capacity quantity + quarterly weightings x quarterly capacity quantities + ...)

Therefore

Annual price = allowed revenue / (annual capacity quantity + quarterly weightings x quarterly capacity quantities + ...)

- 7.8. Omitting the quarterly and other weightings would therefore result in a reference price, which, when used to calculate annual revenues, would not give the allowed revenue required by the licence.
- 7.9. The forecast annual capacity tariff is applied to both the entry and exit points; therefore the tariff will be the same at entry and exit points.
- 7.10. The resulting annual firm entry tariff is the reference price used for the calculation of reserve prices for the short term entry capacity products set out in Step 3.
- 7.11. The forecast commodity tariff for the transmission network is calculated as now by multiplying the total TSOs' revenue requirement that has been allocated to the commodity element divided by the total forecast commodity

volumes.

7.12. The formula to determine the commodity tariff is calculated at the beginning of the year would be:

$$\text{Forecast Annual Commodity Tariff} = \text{Total Forecast Required Revenues (allocated to commodity charges)} / \text{Total forecast commodity}$$

STEP 3: Calculate the reserve prices for short term capacity products

7.13. The annual firm capacity tariff calculated in STEP 2 is used to calculate the reserve price for the short term capacity products together with the relevant seasonal factor, multipliers and time factors.

7.14. The reserve price for quarterly, monthly and daily firm capacity is calculated according to the formula below:

$$P_{st} = M \times (P_y / 365) \times D \times S_m$$

Where:

P_{st} is the reserve price for the respective short term (st) capacity product;

M is the level of the multiplier corresponding to the respective standard capacity product;

P_y is the reference price;

D is the duration of the respective standard capacity product expressed in gas days.

S_m is the seasonal factor for the relevant month (m=1-12)

7.15. The calculation above results in a reserve price for the quarterly, monthly and daily firm capacity products. These reserve prices are used in the

auctions which are carried out throughout the gas year and discussed in the following section.

- 7.16. With regards to timings, we expect that the tariffs will be calculated and shippers notified in line with existing arrangements i.e. reserve prices for all products published in August prior to the start of the gas year. We will ensure that we adhere to any rules contained in the network code on tariffs when it is finalized.

Capacity auctions and invoice payment cycle

Invoice Payment Cycle

- 7.17. In order to minimise the credit risk exposure to one another, we propose that the three TSOs will continue to operate a trustee account system. As with current arrangements, all postalised transmission charges at entry and exit points will be paid into a common account which will be held in trust for the transporters in proportion to their entitlements and from which distributions will be made to each TSO. Monthly distributions will reflect the proportionate entitlement of each TSO and will include the liability to VAT which it will need to discharge on transmission charges invoiced to shippers. As such we propose revenue collection arrangements based on the current practice. Also bad debt will be dealt with similarly to current arrangements, including the credit committee.
- 7.18. As set out in section 2, under current arrangements the Postalised System Administrator (PSA) administers the postalised arrangements. However under the new tariff arrangements we propose that this role could be carried out jointly by the TSOs.
- 7.19. Shippers will continue to receive invoices from the TSOs on a monthly

basis for the transmission services that they have used in the relevant period. Under current arrangements shippers pay for their annual capacity booking at exit (divided by 12) and the amount of commodity used within the month.

7.20. Under future arrangements, since there will be multiple capacity products available at entry and exit plus commodity charges at exit, there will be multiple entries on the shipper's invoice (the extent of which depend upon the shipper's use of short term capacity products).

7.21. A shipper's invoice will therefore have a charge for the individual capacity products that they have used and for the commodity that they have flowed for the relevant period for both entry and exit. Payments will be made to the TSOs which will be paid into the PoT (as defined in section 2). We propose that the PoT will hold both entry and exit payments.

Auctions

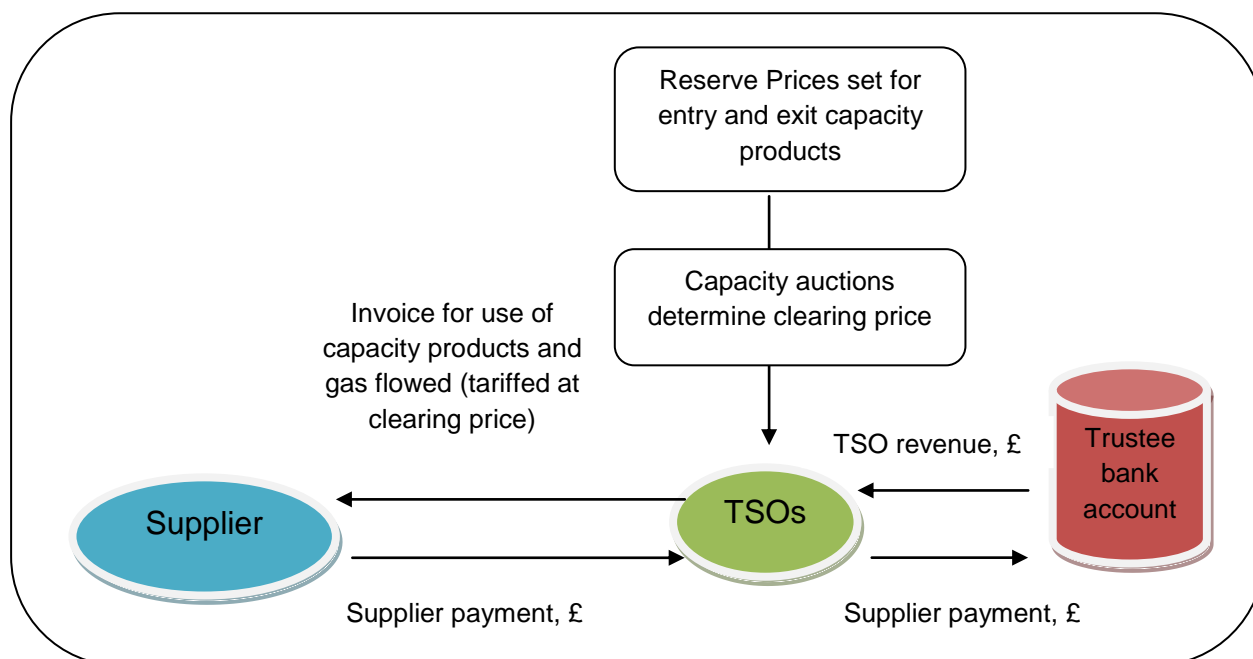
7.22. Throughout the year auctions will be held via the PRISMA platform for the relevant capacity product.

7.23. If the outcome of an auction is that the clearing price is greater than the reserve price (i.e. there is an auction premium¹³) then shippers will pay the clearing price for that capacity product and this will be reflected on the shippers' invoices. Otherwise the reserve price is used to calculate the payment.

7.24. Figure 2 below demonstrates the proposed process.

¹³ The tariff network code defines an 'auction premium' as the difference between the clearing price and the reserve price in an auction

Figure 2: Capacity auctions and invoice payment cycle



End of year reconciliation

7.25. At the end of the year the TSOs will finalise their suppliers' actual volumes (and if applicable their actual operational expenditure) and the actual capacity bookings for each of the products over the course of the year for both entry and exit.

7.26. Under current arrangements transporters are obligated to provide quarterly updates on actual volumes no later than 10 Business days after the quarter. We propose that this requirement will be extended to include the actual capacity bookings. This will help suppliers estimate the impact of any end of year reconciliation payment.

7.27. The issues that could prompt a large bullet payment are:

- Forecasting error
- PTL/BGTL ARR is greater than FRR
- Auction clearing prices differ from reserve price

7.28. We propose that the TSOs then calculate the year end annual capacity tariff and year end commodity tariff from the finalised volume, capacity and revenue figures. The end of year tariffs for the short term products are then calculated using the year end annual firm capacity tariff by applying the relevant seasonal factor and multiplier i.e. the calculation uses the same formulae as set out in STEP 3 but with the year-end annual firm capacity tariff substituted for the forecast annual firm capacity tariff. This will result in year-end tariffs for all of the capacity products and a year-end commodity tariff.

7.29. Individual shipper reconciliation payments are then calculated for each capacity product (used at entry and exit) by multiplying the amount of capacity used for each capacity product by the difference between the relevant year-end tariff and the forecast tariff.

7.30. Similarly individual shipper reconciliation payments for the commodity element are calculated by multiplying the actual amount of gas flowed by the difference between the year-end and forecast commodity tariff.

7.31. The individual shipper capacity and commodity reconciliation payments are then summed to give a single reconciliation payment per shipper. A single reconciliation payment across entry and exit could facilitate one bullet payment between shippers and the TSOs.

7.32. The TSOs are allocated a reconciliation payment/rebate based upon their portion of the total required revenues.

7.33. If there has been an auction premium in any of the short term capacity auctions then the reconciliation process calculates the difference between the

year-end tariff and the clearing price (rather than the forecast tariff) for the relevant capacity product. We propose that any premium from a capacity auction goes back to consumers; any premium could go towards meeting the overall allowed revenue therefore customers would benefit from a lower end of year tariff in the reconciliation process. The premium will not therefore be retained by the TSOs.

7.34. As demonstrated in Table 2 the actual entry exit revenue split is determined once the actual figures have been finalized at the end of the year as an output of the reconciliation process.

7.35. We propose (subject to the tariff code when finalized) that the timings for this process will be similar to current arrangements i.e. the reconciliation process for the gas year (which has ended in September) is carried out by the TSOs in the following November with notification to shippers of the year end tariffs in December. The reconciliation/rebates are then included in the invoice issued in the following January.

8. Next steps/timetable for further work

Next steps

- 8.1. As set out in section 1 the UR welcomes comments on the proposals in this paper by 27 November 2014. We have also held a workshop to discuss the proposals with NI industry on 16 October.
- 8.2. Following the receipt of comments on this paper we will finalize our conclusions on the introduction of entry capacity charges into the NI postalised regime with the intention of publishing a conclusions paper in December 2014/January 2015.

Development of licence changes

- 8.3. The introduction of entry capacity will require changes to the TSO licenses which will require further discussions with the TSOs.
- 8.4. In addition there may be changes needed to the licenses of the gas distribution network operators (GDNs) and suppliers to reflect the fact that suppliers will be responsible for booking entry capacity rather than the GDNs.
- 8.5. The Utility Regulator will undertake the work to develop licence changes and discuss these with the relevant parties (TSOs, GDNs and suppliers).
- 8.6. A postalisation model must also be developed to calculate the postalised tariffs, shipper invoice amounts and reconciliation payments. The Utility Regulator will undertake this work as set out below.

Postalisation model

- 8.7. The introduction of entry charges also requires a new spreadsheet model to calculate the forecast charges, auction reserve prices, deal with revenue flows to the TSOs and reconciliation. This model is being developed by the UR and an illustrative version of it will be published later in October for industry review.
- 8.8. Once we have finalised our conclusions on the introduction of entry capacity charges into the NI postalised regime the model will need to be tailored to those conclusions. Once this is done we intend to publish the final version of the model.
- 8.9. The model must be finalized ready for use in the summer of 2015 to calculate forecast postalised charges and auction reference prices.

Changes to TSO network codes and contracts

- 8.10. The introduction of entry capacity products will also require changes to TSO network codes and changes to the TSO contracts related to postalisation will also be necessary. The TSOs have already commenced the process of code development for the new entry products and this work is illustrated in the TSOs' work programme.
- 8.11. Where changes to TSO contracts related to postalisation are required as a result of the UR's conclusion on postalisation the TSOs will bring forward proposals to UR.

Indicative timetable

- 8.12. A summary of the indicative timetable for the work associated with entry tariffs is set out below.

Table 4: Summary of the timetable for the work associated with entry tariffs

Date	Task	Responsible
16 th October 2014	Publish tariff consultation	UR
16 th October	Workshop on tariffs	UR
27 th November 2014	Tariff consultation closes	
November to December 2014	Scoping of licence changes and initial discussions with licensed entities as necessary	UR
December 2014/January 2015	Tariff conclusions published	UR
December 2014 to January 2015	Continue discussions on licence changes Workshop on licence changes as necessary in January	All UR
January/ February 2015	Statutory consultation starts on the licence changes (assumes 28 days statutory)	UR
End March 2015	Licence amendments in place.	UR

Appendix 1: List of consultation questions

Q1	We welcome views on the requirements for the new entry tariff methodology set out in section 4.
Q2	We welcome views on our proposal to apply the postage stamp cost allocation methodology
Q3	We welcome views on our proposal to maintain the current 75:25 split at exit and at entry for 2015 but to revisit this again for 2017 once the EUNC on tariff is finalised.
Q4	We would welcome views on our proposal that the entry-exit split should be an output from the reconciliation process.
Q5	We welcome views on our proposal to make full use of the flexibility to set multipliers and seasonal factors.
Q6	We welcome views on the proposal to retain a single PoT for holding revenues from both entry and exit.
Q7	We welcome views on our proposal to reconcile the entry and exit points together.
Q8	We welcome views on discontinuing the daily capacity product at exit from 1 October 2015
Q9	We welcome views on our proposal that a supplier nominating above the level of booked capacity at an exit point will be charged at an appropriate rate for capacity in addition to the commodity charge.